

## BACKGROUNDER

### VIDEO GAMES: PAST, PRESENT AND FUTURE; AN INDUSTRY OVERVIEW

Since they were introduced a decade ago, video games have made a striking progression from basic graphics and game play to high-tech visuals and challenging themes, all in a relatively short period of time. While the category has experienced downturns and upswings, continued efforts to develop more sophisticated hardware and software have earned video game play its current status as a pervasive part of popular culture.

When Pong was introduced to enthusiastic players in 1979, with 8 kilobits of memory, it marked the beginning of the first generation of video games. For the most part, these games featured primitive graphics, limited movement capabilities and simple objectives.

As video games moved into the arcades, machines with larger memory capacity enabled software to become longer-playing and more elaborate. For the first time, games such as Nintendo's "Donkey Kong" and "Pac Man" featured more developed story lines and more complex graphics. These games required thought and reasoning skills, in addition to the simple eye-hand coordination needed to conquer previous titles.

In 1985, the video game market crashed to an all-time low of \$100 million in close-out sales. Contributing to this drastic downward trend in software sales was the halt in video game software evolution. Instead of moving towards new technology or the introduction of different game categories, the market grew stagnant with games which replicated each other in content, image and level of challenge.

In the fall of 1986, Nintendo<sup>R</sup> revitalized video game development by introducing its Nintendo Entertainment System<sup>R</sup> and software more sophisticated than any the industry had seen before. Games such as "Super Mario Bros."<sup>R</sup> with 256 kilobits of memory, and "The Legend of Zelda,"<sup>TM</sup> with 1 megabit of memory, captured the imagination of millions of video game fans across the nation and brought arcade-quality graphics into their homes. The second generation of video games had begun.

Player challenge and game complexity became critical elements to the sophisticated new generation. "The Legend of Zelda," in particular, introduced the role-playing themes which took video games to their next evolutionary step. "Zelda's" hero "Link" is guided by players through fanciful settings and mazes, which grow more complex as the adventure progresses. To accommodate the in-depth nature of the game, players have the opportunity to save game play for continuation at a later time with the help of a lithium battery.

## Industry Overview

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Nintendo has also brought more realism to sports and action games, such as "Mike Tyson's Punch-Out!!"™ and "Kung-Fu," both featuring creative characters and life-like scenarios. Sports games designed for the NES Power Pad™ accessory marked Nintendo's effort to provide players with true game interaction.

As the second generation of video games moves into its third year in the U.S., Nintendo continues to chart new territory in video game development. Games such as "Super Mario Bros. 2"™ -- with two megabits of memory -- offer more challenge, while "Dragon Warrior"™ is a complete role-playing fantasy adventure. Players actually experience the action from the point of view of the plot's main character and must use deductive reasoning to achieve the ultimate goal. Not only does "Dragon Warrior" offer the player more choices than in any other game, it actually gives the player immediate feedback about the choices he has made.

Intent on remaining on the cutting edge of video game technology, Nintendo introduced a new product line centered around Game Boy,™ an innovative portable video game system, in late 1989. The system features interchangeable cartridges and offers multi-player action and stereo sound.

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## Industry Overview

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Also, in 1989, Nintendo of America announced the NES Network, an interactive entertainment and informational system set to debut in 1990. The network has the potential to go far beyond video games by allowing NES owners the ability to access information on the stock market, travel tips and home shopping via the NES Control Deck.<sup>TM</sup>

The future of game progression is already reality in Japan, where the newest versions of the role-playing game series feature three and four megabits of memory. Nintendo plans to ensure the future of video game entertainment, by staying a step ahead of players, by creating novel software titles and categories, and by constantly tailoring software to appeal to all age groups and interests.

Nintendo of America Inc. sells personal, home and arcade video games in the United States. The Redmond, Washington-based company is the headquarters for the company's marketing operations in North America; and is a subsidiary of the world's largest manufacturer and marketer of video games, Nintendo Co. Ltd.

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## VIDEO GAME INDUSTRY HISTORICAL REVIEW

### 1979

- Pong, a game invented by Nolan Bushnell, dominates the video game market.
- The video game craze begins in earnest with the first shipment of the Atari.
- Total market dollar value (hardware, software and accessories) is \$330 million.

### 1980

- Atari's 2600 system dominates the market with 44 percent share.
- Americans spend \$464 million on video games.

### 1981

- Sales double to almost one billion with Atari leading the way.
- Mattel enters the market with \$250 million in sales.

### 1982

- Video game sales skyrocket to \$3 billion late in the final quarter of the year.
- Atari reports \$1.7 billion dollars in sales.
- Colecovision enters the market with \$286 million in sales.

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## Industry Historical Review

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### 1983

- In the first quarter of the year, the video game market hit its peak, but dumping and discounting become rampant in the last half of 1983 as poor quality games flood the market.
- Sales drop to \$2 billion, a 33 percent decrease by year-end.
- In an attempt to salvage investments in technology and manufacturing, video game makers enter the home computer industry; and Coleco fails to deliver the Adam home computer in time to meet crucial Christmas orders.
- By year-end, software prices dip dramatically. Games which had sold for \$35 become available for \$5.
- Nintendo Co. Ltd. (Kyoto, Japan) introduces the Family Computer System (Famicom) in Japan.

### 1984

- Atari shows its latest product -- the 7800 -- but withholds it from the market.
- Video game category sales fall to \$800 million.
- Coleco ceases manufacturing; Mattel closes its electronics division and Warner Communications sells Atari at a firesale price.

### 1985

- Balance of first generation video game companies withdraw from the market or reorganize.

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## Industry Historical Review

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### 1985 (Cont'd.)

- Meanwhile the video game industry continues to flourish in other countries; in Japan, consumers purchase more than 6.5 million Nintendo Family Computer systems (Famicom).
- Total U.S. market sales hit a record low of approximately \$100 million.
- In late autumn, Nintendo successfully test markets the Nintendo Entertainment System® (NES) -- the first of a new generation of video games -- in New York.

### 1986

- Nintendo of America Inc. uses improved technology to lead the resurgence of the home video game market by introducing the NES across the U.S.; other players include Sega, Atari and INTV. Nintendo sold more than one million systems and captured more than 70 percent of the "new generation" home video games sales.
- "New generation" video game manufacturers sell 1.4 million units; Nintendo of America Inc. sells 1.1 million alone.

### 1987

- Nintendo predicts industry sales of \$825 million with the company's share accounting for \$650 million -- sales that surpass the Cabbage Patch Kids at their peak. Actual sales reached \$1.1 billion for the industry, and \$750 million for Nintendo and its licensees.
- Sega signs a marketing and distribution agreement with Tonka, and Atari reopens its video game division.

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1987 (Cont'd.)

- Robust year-long sales, combined with strong Christmas sales, prove Nintendo's projections conservative. The home video game industry sold 4.1 million units of hardware. Nintendo's share of those sales was 3 million units -- 200,000 units short of what could have been sold if supply had been sufficient.
- "The Legend of Zelda"® becomes the first million seller of the new generation of home video games software.

1988

- Industry sales reach \$2.3 billion, comprised of more than 8 million units of hardware sales and 43 million units of software sales.
- Nintendo launches the Power Set™, featuring an interactive control mat -- the Power Pad™ -- which allows a player's body movements to control the action of characters on the screen.
- Both "The Legend of Zelda" and "Mike Tyson's Punch-Out!!" -- hit sales of two million units.
- Nintendo introduces sequels to its most popular titles with the launch of "Super Mario Bros. 2"™ and "Zelda II -- The Adventure of Link."™
- More adults and more females become video game fans. Nintendo's data shows 20 percent of their players fall into the 25-44 year-old age range, while 27 percent are female.
- Nintendo's number of third-party licensees grows to 36.

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Industry Historical Review

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1989

- Nintendo's family expands to incorporate a total of 50 third-party software and accessory licensees.
- The home video game industry reached \$3.4 billion in sales.
- **NINTENDO POWER<sup>®</sup>** magazine becomes the largest paid-subscription publication in its age category with more than one million subscribers.
- Nintendo introduces Game Boy,<sup>™</sup> a portable video game system with interchangeable cartridges and stereo sound.
- Sega and NEC showcase 16-bit video game systems.
- Nintendo introduces "Tetris,"<sup>™</sup> the first Soviet-developed video game to be produced in America.
- Nintendo's networking division is formed with plans to bring the NES Network entertainment and information system to the United States.
- Sega begins to contract with several third-party licensees.
- Nintendo inaugurates the NES Hands-Free controller, specially developed to allow the physically disabled to enjoy video game play.
- Video games are projected to reach 21 percent U.S. household penetration.

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1990

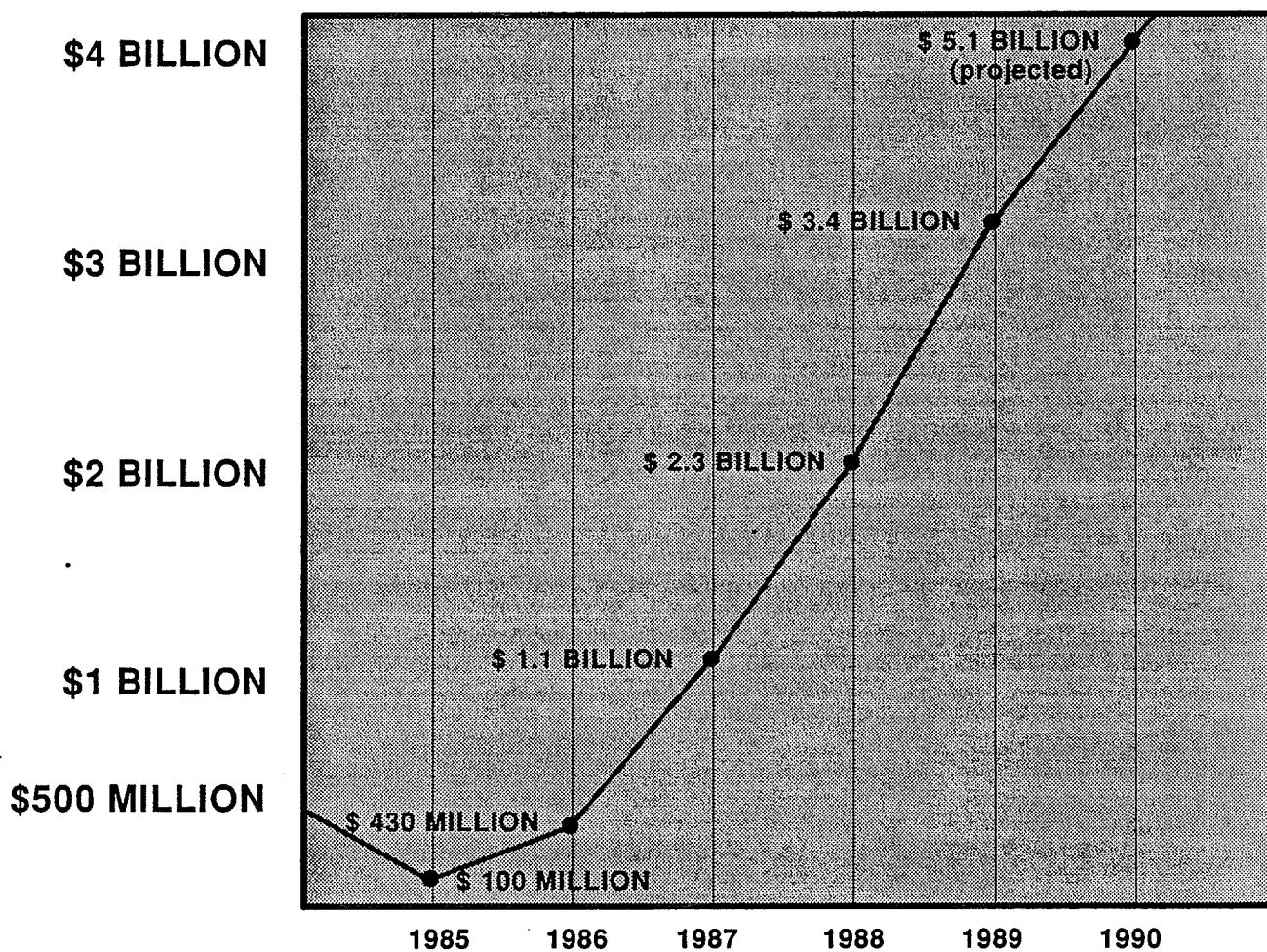
- The home video game industry projects \$5.1 billion in sales, of which \$4.1 billion will be attributed to the sales of Nintendo and its licensees.
- Nearly 50 software developers have begun to develop game titles for Game Boy.
- 4.5 million Game Boy units and 17 million software units for the hand-held unit are projected to sell in 1990.

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Source: Nintendo of America Inc.